BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of

VELSICOL CHEMICAL CORPORATION

Appearances:

For Appellant: Paul F. Cook, Certified Public Accountant; Bernard H. Lorant, Vice-President, Velsicol Chemical Corporation; Joseph A. Rattigan, Attorney at Law

For Respondent: Crawford H. Thomas
Associate Tax Counsel

O P I N I O N

This appeal is made pursuant to section 25667 of the Revenue and Taxation Code from the action of the Franchise Tax Board' on the protests of Velsicol Chemical Corporation against proposed assessments of additional franchise tax in the amounts of $248.59, $321.51, $1,009.52 and $1,327.43 for the income years ended August 31, 1955, December 31, 1955, December 31, 1956, and December 31, 1957, respectively.

The question presented in this appeal is whether gains from the sale of certain patent rights, and royalties under a license to use a patent are allocable in part to California as income of a unitary business.

The business presently conducted by appellant was acquired by it through a reorganization, the details of which are not material to the question presented. For convenience, we shall treat the matter as if appellant had operated the business since its inception.

Appeal of Velsicol Chemical Corporation

Appellant is an Illinois corporation which, since 1931, has been engaged in the development, manufacture and sale of chemical products, including chlorinated insecticides. It commenced doing business in California in July 1946. Over the years appellant has developed a number of trade secrets, techniques and patents for use in its business.

At its research facilities in Illinois appellant developed certain insecticides known as chlordane, aldrin and dieldrin, through the efforts of one, of its officers, Julius Hyman, and others. In September 1946, Mr. Hyman resigned and formed another company. In a series of law- . suits that ended in 1952, appellant prevented the Hyman company from producing and selling chlordane, aldrin and dieldrin and obtained assignments of the patent rights relating to those products. Shortly thereafter, appellant sold to Shell Development Company its rights to aldrin and dieldrin for a flat sum plus an annual percentage of Shell's receipts from sales of those products over a period of 15 years.

In addition to the annual payments from Shell Development Company during the years in question, appellant received royalties in the years 1956 and 1957 under a licensing agreement with Hooker Chemical Corporation. The subject of the licensing agreement was certain chlorendic material which appellant patented in 1944.

Prior to executing the assignment to Shell and the licensing agreement with Hooker, appellant had not commercially manufactured or sold the particular products covered by the assignment or license. It does not normally sell, assign or license its patents or inventions. The transaction with Shell represents the only sale by appellant of any of its patent rights.

In its California franchise tax returns for the years involved, appellant did not include any portion of the receipts from the above described assignment and license in the measure of the tax. This appeal resulted from respondent's action in allocating a portion of those payments *to* California *on* the ground that they constituted income of a unitary business.

Pursuant to *section* 25101 of the Revenue and Taxation Code and the regulations adopted under it, the

income of a unitary business conducted within and without this state is allocable in part to California by a formula composed of income producing factors of the business. Respondent's regulations exclude from formula allocation any income from property which is not a part of or connected with the unitary business. (Cal. Admin. Code, tit. 18, reg. 25101, subd. (d)(l), formerly reg. 24301, subd. (c)(l).)

It is undisputed that the business here involved is unitary in nature. Citing our decisions in Appeal of Houghton Mifflin Co., Cal, St. Bd. of Equal., March 28, 1946, and Appeal of International Business Machines Corp., Cal. St. Bd. of Equal., Oct. 7, 1954, appellant argues that "Since the sales and collection of royalty from intangible personal property are not a regular integral, recurring part of the unified business operations, they should be excluded from unitary income." Appellant also emphasizes that until the occurrence of the transactions with Shell and Hooker, it had not commercially manufactured or sold the products covered by the patents here involved.

In the appeals cited we held that income from intangible property was allocable income of the unitary business where the acquisition, management and disposition of the intangibles constituted integral parts of the corporation's regular business operations. That is not to say that the manner of disposition, whether usual or unusual, is controlling. On the contrary, we have held that income from an abnormal liquidation of inventories (Appeal of Wesson Oil and Snowdrift Sales Co., Cal. St,, Bd. of Equal., Feb. 5, 1957) and from the sale of capital assets of a kind not regularly sold in the business (Appeal of American Airlines, Inc., Cal. St, Bd. of Equal,, Dec. 18, 1952; W. J. Voit Rubber Corp., Cal. St. Bd. of Equal., May 12, 1964) constituted unitary income subject to allocation by the formula method.

As we stated in the W. J. Voit appeal, supra, any income from assets which are integral parts of the unitary business is unitary income. It is approprfate that all returns from property which is developed and maintained through the resources of and for the purpose of furthering the business should be attributed to the business as a whole.

The development of insecticides, the acquisition of patents upon them, the protection of the patents and the exploitation of them were integral and highly important aspects of appellant's business. The insecticides under consideration here were developed in the regular course of appellant's business at facilities maintained by the business for that purpose, Patents on the products were secured and protected in the normal course of operations and the patents were held available for exploitation as the best interests of the business might dictate. The patents were integral assets of the business and the income therefrom was attributable, to the business as a whole.

Whether the insecticides were developed before or after appellant began doing business in California is immaterial since the property rights were integral assets of the unitary operation after the business was extended to this state.

In our opinion, respondent did not err in allocating a portion of the income in question to California as income of a unitary business conducted partly in this state.

ORDER

Pursuant to the views expressed in the opinion of the board on file in this proceeding, and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to section 25667 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protests of Velsicol Chemical Corporation against proposed assessments of additional franchise tax in the amounts of $248.59, $321.51,

$1,009.52 and $1,327.43 for the income years ended August 31, 1955, December 31, 1955, December 31, 1956, and December 31, 1957, respectively, be and the same is hereby sustained.

Done at Sacramento, California, this 5th day of October, 1965, by the State Board of Equalization.

, Chairman

, Member

, Member

, Member

, Member

ATTEST: , Secretary